March 2003
IMF Country Report No. 03/87

Eastern Caribbean Currency Union: Discussions with Regional Institutions—Staff Report; and Public Information Notice on the Executive Board Discussion

This staff report on discussions with regional institutions for the Eastern Caribbean Currency Union (ECCU) was prepared by a staff team of the International Monetary Fund in the context of the periodic regional surveillance on the ECCU. The regional perspective of such discussions is intended to strengthen the bilateral discussions that the IMF holds with the members in the region under Article IV of the IMF's Articles of Agreement. The following documents have been released and are included in this package:

- the staff report, prepared by a staff team of the IMF, following discussions that ended on September 21, 2002, with the officials of the ECCU regional institutions on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 9, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its January 27, 2003 discussion** of the staff report that concluded the discussion of regional surveillance.

The document(s) listed below have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

EASTERN CARIBBEAN CURRENCY UNION

Staff Report Following Discussions with Regional Institutions

Prepared by Staff Team

Approved by Guy Meredith and G. Russell Kincaid

January 9, 2003

- Discussions with the Eastern Caribbean Central Bank (ECCB), the Secretariat of the Organization of Eastern Caribbean States (OECS) and the Caribbean Development Bank (CDB) were held in Basseterre, St. Kitts, Castries, St. Lucia and Bridgetown, Barbados during September 9–21, 2002. The mission consisted of Mr. Boote (Head), Ms. Turner-Huggins (leader of the advance team), Mr. Njoroge (all WHD), Messrs. Price (PDR) and Worrell (MAE). The mission met with Governor Venner of the ECCB, Mr. Goodwin, Acting Director General of the OECS, and Mr. Slusher of the CDB. The mission also visited the CARTAC office. Mr. O'Murchu, Alternate Executive Director, and Ms. Lewis-Bynoe, Advisor, Executive Director's office, attended the final meetings.

- The Eastern Caribbean Currency Union (ECCU) comprises six Fund members: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines; and two British territories, Anguilla and Montserrat. ECCU countries are members of the ECCB, with a common currency, the Eastern Caribbean dollar, which has been pegged to the US dollar at EC$2.70=US$1.00 since 1976. All six Fund members have accepted the obligations of Article VIII Sections 2, 3, and 4, and maintain exchange and trade regimes that are generally free of restrictions. ECCU members participate in the Fund's General Data Dissemination System (GDDS), and while statistics are generally adequate for surveillance purposes, there is need for improvement in some key areas. Dominica is the only ECCU country with a Fund-supported program. Grenada is requesting emergency assistance to cover the damage caused by tropical storm Lili in September 2002.

- At the conclusion of the 2001 Article IV consultation with St. Lucia on March 7, 2001, the Board considered a background paper on regional developments. At that time, they noted the slowdown in output, fiscal deterioration and rising debt levels. They urged the authorities to take urgent steps to arrest widening fiscal deficits especially in light of the fixed exchange rate regime and currency board arrangement. In the financial sector, they encouraged strengthening the regulatory and prudential regimes for both the domestic and offshore sectors. On the structural front, they urged monitoring external competitiveness and making preparations for trade liberalization.

Contents

Executive Summary

Recent Developments: The macroeconomic situation in the ECCU is weak following an unprecedented decline in output in 2001, which continued in 2002. Given the global slowdown, the lingering effects on tourism of the September 11 attacks and natural disasters, the prospects for recovery in 2003 are limited. The fiscal position remains serious, as deficits have widened across the Union and overall debt levels are rising. The stability of the fixed exchange rate, supported by the currency board arrangement, hinges on fiscal consolidation. Efforts to reinvigorate growth need to focus on private sector led development, and enhancement of the region's competitiveness. Inflation is subdued, while unemployment is worrisome.

Policy Discussions: Discussions focused on the outlook for 2003 and the policy responses needed to arrest the fiscal deterioration and to achieve consolidation over the medium term. While the short-term outlook for growth appears weak given the external climate, the region can look toward benefits from deeper regional and global integration over the medium term. Several major challenges remain. The mission emphasized:

- **The unsustainability of fiscal deficits,** which poses a risk to the stability of the currency board arrangement. Urgent action was required to reduce these deficits. The mission noted the economic difficulties facing Dominica; the program supported by the Fund can serve as a catalyst to corrective policies elsewhere in the ECCU.

- **The usefulness of fiscal benchmarks to frame medium-term objectives**. The mission supported the direction of the ECCB's proposed fiscal benchmarks for its members, but considered that more work needed to be done to ensure that they are consistent with debt sustainability.

- **Strengthened debt management.** The mission supported the region's efforts to monitor debt through the Regional Debt Coordinating Committee, and suggested that its efforts focus on domestic and external debt management, reducing costs and avoiding expensive new debt contracts.

- **The need for a strategy to re-invigorate growth**. While part of the sluggish economy can be explained by the global slowdown and the impact of the September 11 attacks on tourism, as well as hurricanes, the region appears to be suffering from a loss of competitiveness.

- **The importance of determined implementation of the plan of action for strengthening supervision of the financial sector,** both domestic and offshore, especially in light of the weak economy.

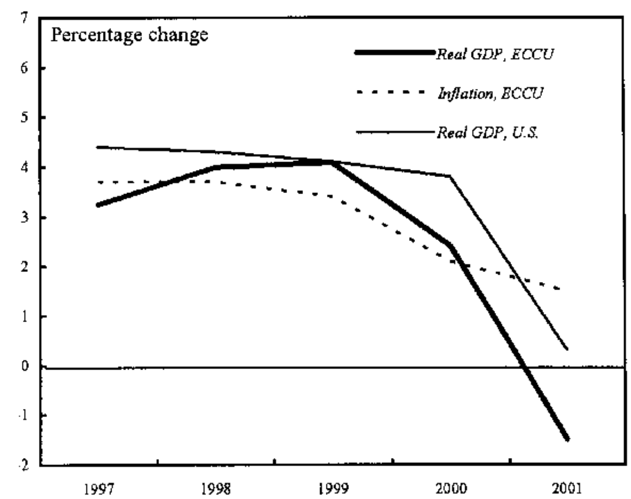
- **Structural reforms are needed to improve efficiency,** in advance of new trade arrangements, including the Free Trade Area of the Americas (FTAA), to meet the recently announced goal by the OECS Heads of Government of a single economic space by 2007.

- **Risks to recovery** include spillover of a country crisis to other members of the ECCU, adverse external developments, and failure to implement the needed fiscal consolidation.

I. Economic Background

1. **After growing at an average annual rate of 3½ percent in the 1990s, real GDP in the region grew by 2½ percent in 2000, and fell by 1½ percent in 2001, a decline unprecedented since 1976.** This fall reflected a confluence of events: September 11th and its impact on tourism, steep declines in traditional products (notably bananas and sugar), natural disasters, including the impact of tropical storm Lili in September 2002 on Grenada and St. Vincent and the Grenadines, and the global economic slowdown. Loss of competitiveness is also evident in tourism and trade. Economic activity in 2002 remained depressed. Inflation is subdued, with consumer prices rising on average by less than 3 percent per year. Unemployment appears to be high, although reliable data are not readily available.

Figure 1. ECCU: Output and Inflation

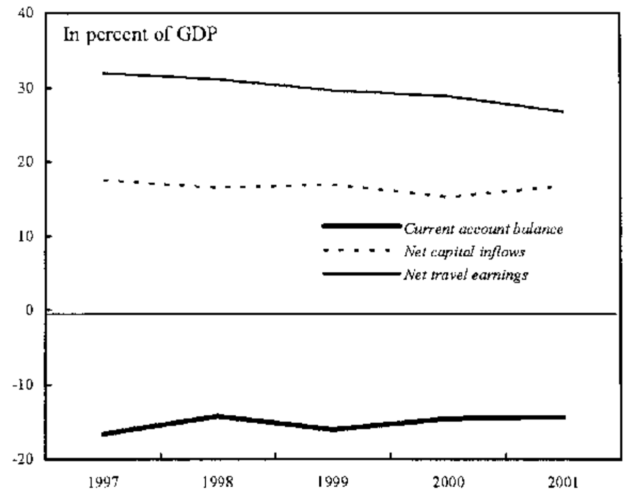


2. **The fiscal position of the region has deteriorated sharply in recent years, resulting in public sector dissavings, marked increases in public debt, and arrears in some cases (Dominica, Antigua and Barbuda).** The central government deficit[1] widened from 5½ percent of GDP in 2000 to around 7 percent of GDP in 2001, and is projected to have remained broadly unchanged in 2002. Higher spending was mostly on wage bills, capital projects, and interest payments. Widespread tax concessions lowered revenues, which have declined by 1.5 percentage points of GDP over the last two years. The combined overall stock of public sector debt grew to about 80 percent of GDP in 2001. Within the countries in the region, the debt stock at end-2001 ranged between 40–135 percent of GDP. Further increases were expected for 2002. Most of the debt is of a concessional nature, and largely long-term (see Figure 3), although recently some countries have had recourse to often expensive commercial borrowing.

[1] Based on central government balances, including grants.

3. **Despite generally large current account deficits and declining external competitiveness, gross reserves have risen moderately in recent years.** With continued robust capital inflows, mainly direct investment to finance construction and other imports for large projects but also borrowing to finance public sector spending, a significant positive overall balance was recorded in 2001, allowing gross reserves of the ECCB to rise to the equivalent of four months of imports of goods and services. Travel receipts, imports, and exports fell sharply with the slowdown in tourism and in the economy, and the current account deficit narrowed slightly to an estimated 15 percent of GDP. The deficit is projected to have remained broadly unchanged in 2002, with further weakness in tourism offset by an increase in exports and lower imports. Following a long period (over ten years) of appreciation, the Eastern Caribbean dollar in real effective terms depreciated by 3 percent in 2002,[2] mostly reflecting the weakening of the US dollar (see Figures 4 and 5).

Figure 2. ECCU: External Accounts



4. **Monetary aggregates grew strongly in 2000 but growth slowed in 2001 and 2002.** The growth in 2000 was driven by increased lending to the governments by commercial banks and an increase in foreign currency deposits, but these trends moderated in 2001 as governments relied more on external borrowing, economic trends worsened and bank liquidity increased. Broad money (M2) grew by 11 percent in 2000 and slowed to 6 percent in 2001, while private sector credit expanded by 10 percent in 2000 and 2 percent in 2001. These trends persisted in 2002 reflecting the sluggishness of the economy; broad money grew by 4 percent in the first six months while credit to the private sector was virtually unchanged. Nominal lending and deposit rates have remained broadly unchanged despite the decline in rates in the rest of the world and a 100 basis point reduction of the ECCB's discount rate in October 2001.

5. **Banking sector soundness varies markedly among members, with domestic (especially state-owned) banks facing particular difficulties.** Given the weak economic climate, the banking system is coming under increasing stress, with problems emerging in a few national banks with a rising level of non-performing loans. International and major regional banks account for 60 percent of the banking system's assets, and are in a stronger position than smaller domestic banks. State-owned banks (those with at least 51 percent state ownership) account for 17 percent of assets, with the remaining 23 percent in domestic private banks. **The**

[2] Through end-August.

level of non-performing loans to total loans remains high: the ratio of non-performing loans for the banking system was 14 percent in March 2002, well above the ECCB's prudential guideline of a maximum of 10 percent. Provisions were low, at 27.8 percent of non-performing loans for domestic banks and 25.6 percent for foreign banks. Banks which do not satisfy all prudential requirements have agreements or signed memoranda of understanding with the ECCB stipulating time frames for correction. Banks were generally profitable, with returns on average assets of 1.9 percent for domestic banks and 2.3 percent for foreign banks.

Box 1. The ECCB's Institutional Arrangements

The ECCB is governed by two Acts: the **Eastern Caribbean Central Bank Agreement Act (1983)** which establishes and defines the powers and operations of the ECCB, and the **Uniform Banking Act (1993)** which defines the operations of financial institutions within the ECCU area including their relations with the ECCB. The ECCB has proposed amending these Acts to tighten their supervisory provisions. The **Monetary Council**, the governing body of the ECCB, comprises the Finance Minister of each of the eight members.

The Eastern Caribbean (EC) dollar has been pegged to the US dollar at EC$2.70=US$1.00 since July 1976, and its relative value can be adjusted only by the unanimous decision of the Monetary Council. The ECCB Act requires the ECCB to hold external reserves for the member countries and territories at no less than 60 percent of its demand liabilities. However, the policy norm for the minimum reserve cover is 80 percent and it has been maintained at over 95 percent for the last several years. Consistent with the reserve cover requirements, the ECCB is permitted to provide credit in various forms to its member countries under strictly specified limits.

The ECCB's **monetary instruments** include reserve requirements, a rediscount facility for treasury bills, and a discount window. The Monetary Council reviews the operation of these instruments regularly. The Banking Act assigns responsibility for **regulating and supervising** the banking sector to the Minister of Finance of each member and the ECCB. The Minister is responsible for licensing (granting, suspending or revoking) upon the nonbinding recommendation of the ECCB, while the ECCB is responsible for supervising these institutions. The ECCB Act provides for limited intervention powers, where a failing institution is of systemic importance. The Banking Act allows the ECCB to require a weak bank to implement remedial measures or to recommend to the Minister that the license be revoked. However, the ECCB does not have powers to impose penalties, intervene in a non-systemic bank, or order the prompt closure of a bank. No lender-of-last-resort facility or deposit insurance fund exists.

6. **In the offshore financial sector, the inclusion in 2000 and 2001 of four countries in the region on the Financial Action Task Force's (FATF) listing of non-cooperative areas, for inadequate anti-money laundering policies, following earlier listings by the Financial Stability Forum (FSF) and the OECD, encouraged efforts by the region's authorities to strengthen the supervisory and regulatory framework.**[3] All of the independent countries of the region have concluded Module 1 assisted self-assessments of their offshore supervisory and regulatory regimes, and a few have formulated action plans to address their shortcomings. However, improvements in supervision have contributed to a decline in offshore activity in the

[3] Grenada and St. Vincent and the Grenadines remain on the FATF list of non-cooperative jurisdictions. Dominica, and St. Kitts and Nevis were removed from the list in 2002.

core areas, particularly banking. This fallout resulted in revenue losses in some countries and calls into question the future of the sector.

II. MEDIUM-TERM OUTLOOK

7. **The medium-term outlook remains uncertain. An early resumption of growth requires prompt fiscal consolidation and a favorable external environment.** Resurgence in growth to past levels depends crucially on a recovery in tourism, which is expected to remain the dominant activity into the medium term. This in turn depends on a global economic recovery and a resumed greater public willingness to fly. Fiscal consolidation is required to free resources for private sector-led growth and investment. Equally, the opportunity provided by the effects on these economies of global economic recovery should be used to reinforce fiscal consolidation. More efficient public spending should permit fiscal consolidation to be accompanied by strengthened social safety nets and needed public investment. A reform of taxes, with fewer exemptions, to a more broad-based system should permit raising revenue in a more growth-friendly fashion. Assuming the timely implementation of favorable domestic policies and a strengthening of tourism and export demand, a modest turnaround would be expected in 2003 and growth could recover over the medium-term to past levels (Table 6).

8. **There are many downside risks both domestic and external.** If fiscal adjustment is delayed, the result will likely be slower growth as private sector investment is squeezed. Given the high level of the public sector borrowing requirement from the financial system, delays in consolidation could also pose a risk to the financial system if fiscal deterioration continues. There is a risk that government arrears to its own banking system in one country could –in some circumstances– lead to more general concern over the stability of banks in the Union and perhaps even the currency arrangement. Prolonged uncertainties in the global economy (caused by war or other factors) will likely delay a recovery of tourism. Tourism is particularly vulnerable to a further terrorist attack.

III. POLICY DISCUSSIONS

9. **The ECCB, OECS and CDB authorities agreed with the mission that the ECCU faces difficult challenges in the period ahead. The main issues highlighted during the discussions were the region's fiscal deterioration especially in light of the currency board arrangement, the high and increasing level of public sector debt, and the need to re-invigorate growth following the decline in economic activity in 2001 and 2002 (including in the offshore financial sector).** The specific crisis in Dominica was cited as a "wake up call" for the region. Success of the Fund-supported program in Dominica will be important in signaling to the rest of the ECCU that structural adjustment pays off. To this end, the authorities felt strongly that Dominica would need assistance from development partners in executing its program.

10. **While the region has launched a number of initiatives to deal with these challenges, they have not yet resulted in significant policy action.** These include the design

of fiscal benchmarks and stabilization programs for each member by the ECCB. Heads of the OECS governments at their recent meetings[4] renewed their commitment to stabilization and the use of peer pressure to ensure compliance with prudent policies. Overall however, the policy response to the regional economic slowdown and the deteriorating fiscal situation has been slow and disappointing. Against this backdrop, the discussions with regional bodies focused on the way forward—especially the actions needed now to arrest the fiscal deterioration, and to establish a coherent medium-term framework (including fiscal benchmarks) within which the problems can be tackled. It is expected that the substance of these discussions will inform the policy discussions with the national authorities in the ECCU, especially in the context of the Article IV consultations.

A. Fiscal Policy [5]

11. **Discussions at the ECCB focused on policies to reduce the large fiscal imbalances and the desirability of agreement on fiscal benchmarks to encourage fiscal discipline in the context of medium-term debt sustainability.** The mission noted that the need for fiscal action was made all the more urgent under a fixed exchange rate supported by the currency board arrangement. For the medium term, the mission regarded the ECCB's fiscal targets (see Table 1) as a minimum requirement, and saw the need for more fiscal adjustment in cases where the central government finances were poor.

12. **The mission indicated that most of the countries in the Union have had a sizeable fiscal deterioration in the last two years due to higher current spending— particularly on wages—and lower revenues reflecting in part persistent large tax exemptions. This reinforced the case for a common, coordinated approach. Urgent fiscal action is required. Efforts should be two-pronged. First, on the expenditure side,** immediate measures to stem current expenditures should be taken in key areas. These should include improving the efficiency of current spending, a freeze in the wage bill (either through cuts in wages or employment) and a real cut in current spending. Additional savings could be achieved by reducing civil service employment, including possibly by contracting out services. Privatization should be speeded up and the proceeds used to retire debt. Better-coordinated and targeted social safety nets should be in place to protect the poor, and spending priorities in health and education protected. Capital spending should focus on projects that promote growth and poverty reduction, particularly those financed by external grants or concessional loans. The

---

[4] OECS Heads of government met in early October 2002, followed by a meeting later in the month by finance ministers at a Monetary Council meeting.

[5] The mission did not meet with finance officials. However, issues arising from these discussions have been raised in subsequent Article IV and other discussions including with St. Vincent and the Grenadines, St. Kitts and Nevis and St. Lucia.

World Bank's public expenditure review,[6] coordinated with the Fund, should be helpful in achieving improved efficiency.

13. **Second, on the revenue side, immediate steps to reverse the recent fall in collections should include reducing tax exemptions and discretionary concessions and liberalizing oil prices (Box 2). Over the medium term, efforts should focus on strengthening revenues through comprehensive tax reform—preferably introduced on a regional basis.** This should aim to widen the tax base including for income tax, strengthen tax and customs administration, harmonize procedures and fiscal incentives (including for investment), eliminate tax concessions, and implement a VAT-like transactions tax. This should be helped by the technical assistance by FAD to assess the tax system in the region and the ongoing work of the regional Tax Commission, mandated to advise on tax policy.

14. **The mission was encouraged by the work underway at the ECCB in designing stabilization programs for members, but emphasized that the fiscal authorities needed to take ownership.** The work being coordinated by CARTAC under the Structural Adjustment Technical Assistance Project (SATAP—to develop stabilization programs) and the coordinating role of the regional debt coordinating committee (RDCC—to oversee domestic and external debt management), and the Tax Commission (TC), will be crucial to the success of reforms envisaged in the context of the fiscal framework and meeting convergence criteria. The mission reiterated that all of the various initiatives underway in the fiscal area need to be monitored closely and that determined implementation will be key to success. Preservation of the regional currency board required rigorous fiscal discipline at the national level.

15. **On the role of fiscal benchmarks**, the mission welcomed the preliminary work of the ECCB to make explicit certain rules of conduct for member countries through a set of fiscal targets (Table 1) or norms of behavior. **However, the mission saw the need for immediate steps to address the fiscal situation, which should be placed within the context of fiscal benchmarks as soon as possible.** Fiscal benchmarks could provide an important framework to reduce internal and external vulnerability and to support the currency board arrangement. They would limit "free-rider" problems by binding members through their pre-commitment to good fiscal behavior.[7] An appropriate mechanism for surveillance and incentive system for compliance should be included in the framework. As indicated in Table 1, none of the six countries has met all four targets adopted by the Monetary Council.

---

[6] See *Selected Issues,* Chapter II, January 13, 2003, http://www.imf.org.

[7] As elaborated in *Selected Issues* Chapter III, January 13, 2003, http://www.imf.org, the ECCB's benchmarks are based on 1990-1998 averages of these data for member countries that met the criterion of public sector investment of 10-12 percent of GDP, as recommended by the CDB.

Box 2. Petroleum Prices in the ECCU

Retail prices on petroleum products in the ECCU remain under government control. Retail prices at end-October 2002 for unleaded gasoline and diesel in the six countries are shown below (in Eastern Caribbean dollars per imperial gallon):

Selected Petroleum Prices

	Unleaded Gasoline	Diesel
Antigua and Barbuda	6.85	6.85
Dominica	7.39	5.97
Grenada	7.95	6.36
St Kitts and Nevis	6.69	5.17
St Vincent and the Grenadines	6.60	4.95
St Lucia	7.75	7.00

Deducting the c.i.f. price of the imported pro duct from the fixed retail price less the negotiated fixed margins for importers and retailers yields a residual margin comprising the net tax. This net tax can be negative and will fluctuate with changes in the c.i.f. price if the retail price is not adjusted. Typically this net tax will in turn be allocated notionally between the various taxes as is expedient in each country (e.g., import duty, customs service charge, consumption tax, sales tax, etc.) with one tax designated the residual (e.g., sales tax in Dominica, petrol tax in Grenada, gasoline levy in St. Kitts and Nevis, and consumption tax in St. Lucia).

Three common themes arise from these pricing regimes:

- The effective taxation on petroleum products is generally low, with a negative or small positive net tax, at an effective rate that is below that of most other imported products.
- The overwhelming experience in the region is that, following an increase in the c.i.f. price, retail prices are kept fixed and the residual margin (net tax) allowed to absorb the increase.
- Even though some governments (e.g. St. Lucia and Dominica) have announced a policy to review frequently and adjust the retail prices, in practice these prices are adjusted only infrequently.

The pricing mechanism for petroleum products could be improved as follows:

- The administered retail prices should be adjusted frequently, monthly or at least quarterly or by the use of a price-trigger.
- The administered retail prices should be calculated using a clear and well-publicized formula that passes to the consumer the absolute change in the c.i.f. price.
- The overall tax on petroleum products should be set at an optimal level, and levied as a specific excise tax.

16. **On debt management, the region should focus on identifying cheaper sources of funding to repay current more expensive commercial debt.** The ECCU should explore the scope for such opportunities through appropriate external financing, as had recently been done by Grenada.[8] In general, the benefits of large amounts of foreign borrowing need to be weighed against the risks and particular care is required to ensure spending does not rise as a result. The mission welcomed the establishment of the Regional Government Securities Market

[8] In June 2002, Grenada floated a US$100 million bond, and has been using most of the proceeds to retire older more expensive debt and financial leases, and for the repayment of arrears.

(RGSM)[9] noting that it will be helpful in reducing vulnerability to external debt build up and provide an efficient mechanism for recycling domestic savings. The RGSM could also play an important role in debt pricing—and allow for market differentiation according to risk. This would be enhanced by greater fiscal transparency and disclosure. Further debt instrument issues, including of treasury bills, should be encouraged to replace existing non-market sources of government debt (including the national insurance schemes) and as a step towards developing capital markets.

Table 1. ECCU: Compliance with Proposed Central Government Fiscal Benchmarks 1/
(in percent of GDP, unless otherwise indicated)

Benchmarks	Status of Implementation of Benchmarks in 2001 by Country						Number of Countries Meeting the Benchmarks			
	Antigua and Barbuda	**Dominica**	**Grenada**	**St. Kitts and Nevis**	**St. Lucia**	**St. Vincent and the Grenadines**	**2001**	**2000**	**1999**	**1998**
Current account surplus (Benchmark: 4 - 6 percent of GDP)	-5.1	-4.1	2.3	-4.9	0.5	0.7	0	1	1	1
Overall deficit (Benchmark: < or = 3 percent of GDP)	-9.7	-11.0	-8.6	-12.4	-3.8	-2.4	1	2	2	1
Govt & govt guar. debt outstanding 2/ (Benchmark: < or = 60 percent of GDP)	84.5	92.1	85.0	138.0	42.7	68.1	1	2	1	3
Debt service payments 3/ (Benchmark: < or = 15 percent of current revenue)	9.4	19.3	2.4	13.5	5.5	5.0	5	5	5	5
Number of benchmarks met in 2001	1	0	1	1	2	2				
Number of benchmarks met in 2000	1	0	2	1	4	2				
Number of benchmarks met in 1999	0	0	3	1	3	2				
Number of benchmarks met in 1998	0	1	2	1	3	3				

Sources: ECCU member country authorities, and Fund staff estimates.

1/ Excludes the territories of Anguilla and Montserrat.
2/ Includes external arrears.
3/ Excludes domestic debt amortization.

17. **The mission highlighted the risks associated with high levels of external borrowings in light of fiscal deterioration and slow growth in the region. It will be important to assess carefully the debt sustainability of each ECCU member.** The ECCB welcomed the Fund's new work in this area (see Box 3). The mission noted the need for data collection in the area of private sector external claims including on short-term debt, as well as contingent liabilities of the rest of the public sector (data are not available in many of these areas, and partial at best for a few countries).

[9] St. Kitts and Nevis issued the first government bond on the RGSM in November 2002.

Box 3. Fiscal Vulnerabilities and Debt Sustainability

Staff conducted fiscal sustainability analyses using the framework recently developed by IMF staff.[1] Stress tests were applied to three different scenarios for four of the countries.[2] The tests indicate that fiscal situations in **Antigua and Barbuda** and **St. Kitts and Nevis** are particularly vulnerable. Applying recent historical averages for key macroeconomic variables to the baseline projections results in marked increases in the respective debt ratios, and divergences from the projections: in Antigua and Barbuda the debt-to-GDP ratio would climb to 120 percent in 2007 (against 92 percent in the staff outlook) from 94 percent in 2002, while in St. Kitts and Nevis the ratio would continue to increase to 169 percent from 157 percent over the same period, compared to staff's projection of a significant decline (to 124 percent). The outcomes are correspondingly worse under alternative "no growth" and "worst case" scenarios (including a possible hurricane). The debt-to-GDP ratios range from 58 percent (**Grenada**) to almost 200 percent (**St. Kitts and Nevis**) in 2007 using historical averages.

No simple rules can be cited for the level of debt that is sustainable or the level beyond which the debt itself could precipitate a crisis. Past crises have occurred in other countries with widely varying debt burdens, in many cases where the debt-to-GDP ratio was below 60 percent—one of the ECCB's proposed fiscal criteria. The ECCB's suggested fiscal guidelines may not be sufficiently ambitious for a region with a fixed exchange rate and substantial borrowing in foreign currency. The implementation of binding fiscal rules could prove a useful commitment mechanism to reverse the rapid build up in debt, but the stress tests further underscore the need for prompt and vigorous fiscal action by national authorities.

Work on these assessments will be continued and completed in the context of the Article IV consultation with the individual countries.

[1] See "Assessing Sustainability," IMF SM/02/166, May 28, 2002.

[2] The three scenarios are (i) *Stabilization or baseline scenario* using staff's current growth and debt projections; (ii) a *no growth scenario* that assumes no (zero) real growth for three years (2003 to 2005) followed by 1 percent and 2 percent growth in 2006 and 2007 respectively; and (iii) a *worst case scenario* that assumes negative growth of 2 percent for three years (2003 to 2005) followed by no (zero) growth for 2 years (2006 and 2007). Complete scenarios were done for St. Kitts and Nevis, St. Vincent and the Grenadines, Grenada, and Antigua and Barbuda, and baseline scenarios were also done for Dominica and St. Lucia. See *Selected Issues (SM/03/16)*, Chapter IV, for more details.

18. **In view of the deteriorating fiscal position of ECCB members, the weak state of the region's economy and the large build up of public sector debt, the mission underscored the importance of reversing these developments to ensure the stability of the currency board arrangement (CBA).** Risk of a fiscal spillover (for example, from an inability to roll over debt)[10] to the financial sector could erode confidence in the CBA. The deteriorating fiscal position also makes domestic banks more vulnerable, since several are heavily exposed to the public sector. Moreover, quasi-fiscal losses stemming from implicit or explicit loan

[10] Data on the maturity structure of domestic debt was not available.

guarantees or bank liquidity problems may aggravate fiscal imbalances. All of this underscored the need for early fiscal correction.

B. External Sector Policy

19. **The ECCB's currency board arrangement with a fixed exchange rate regime has served the regime well since its inception in 1976.** Among the key benefits are low inflation and exchange rate stability. The ECCB enjoys a high degree of credibility as a result. In this context, the ECCB placed emphasis on the stability of the exchange rate as an important anchor. They argued that devaluation would be counterproductive given the wage bargaining agreements and strong unions in the region. Instead, they viewed, and the mission agreed, that the key to safeguarding external competitiveness was through wage restraint throughout the economy and flexible labor and product markets. More generally the mission suggested that increases in real wages should be tied to productivity only and be kept to a minimum, and welcomed recent announcements of measures for wage restraint in some of the countries (e.g., Dominica, St. Kitts and Nevis, and St. Vincent and the Grenadines). The mission agreed with the ECCB that sustaining the current long-standing regime should help maintain macro-stability and enhance integration of the region into the world economy. In recent years, the stability of the regime reflected the ECCB's high currency backing ratio, at over 97 percent compared to the statutory minimum requirement of 60 percent, and its comfortable holding of gross international reserves equivalent to over 4 months of imports or almost one-fifth of broad money (Table 1). Absent the needed measures to ensure wage restraint and enhance competitiveness, there was a risk, however, that preservation of the fixed exchange rate could result in prolonged stagnation.

20. **The exchange regime is generally free of restrictions in the region.** ECCU countries retain requirements for prior approval of payments for invisible transactions above a defined threshold. However, except for St. Lucia, these requirements do not constitute exchange restrictions under Fund jurisdiction since *bona fide* requests above these limits are approved.[11] Except for Antigua and Barbuda, other countries have surrender requirements but these are not enforced.

21. **On measures of external competitiveness, the mission raised concern about certain indicators—including trade and tourism data, which suggest some loss of market share and the need to enhance competitiveness (Box 4).**[12] The modest real effective exchange rate depreciation of the EC dollar in 2002 followed a long period of real appreciation, which added to higher costs especially for the non-US tourism markets (Figure 4). The mission discussed efforts to derive other indicators of competitiveness and noted the ongoing work by the ECCB,

---

[11] In St. Lucia, clearance of tax arrears is required before approval is granted for profit remittances above EC$250,000.

[12] See *Selected Issues*, Chapter I, January 13, 2003, http://www.imf.org.

with the support of the ILO, to develop unit labor costs for member countries, along with productivity indicators. The mission emphasized the importance of sustained efforts to maintain competitiveness, including expenditure and wage restraint (to allow for lower tax burden), and efforts to build human capacity. Competitiveness and structural reforms (lowering costs of doing business, increasing flexibility in the labor, capital, and product markets) are crucial to generating faster growth.

C. Financial System

22. **The mission discussed the ECCB's plans, including legislative changes, to strengthen the domestic bank supervisory and regulatory regime in accordance with Basel Core Principles.** Some urgency is needed given the weakened economy, the large fiscal imbalances and the risks posed by problem banks in such an environment. Various initiatives are underway with the assistance of CARTAC and others. On the Uniform Banking Act, the Fund's Legal and MAE departments have commented favorably on the proposed amendments. For offshore legislation, a new offshore banking Act has been drafted for Grenada by a CARTAC expert that is designed to meet international standards (including some of the FATF 40 recommendations). The draft law is intended as a model for the ECCU members and provides a role for the ECCB in the supervision of offshore banks. The target date for enactment of both legislations is January 2003. The mission considered these initiatives as important to improving deficiencies in the supervision of banking sector, noting the high level of non-performing loans and the need to improve the health of certain domestic banks. In particular, there is still the issue that closure of insolvent banks remains with fiscal authorities, and contingency plans for problem banks need to be articulated. The ECCB does not intend to introduce deposit insurance since 60 percent of the banking system is foreign-owned and 17 percent has majority government-ownership.[13]

[13] See *Selected Issues*, Chapters V and VI, January 13, 2003, http://www.imf.org.

Box 4. Tourism Competitiveness

While ECCU area tourist arrivals grew in the latter part of the 1990s, a troubling trend has been the gradual loss in market share, both in terms of other Caribbean destinations and the world total. Relatively new, low cost Caribbean destinations have in particular captured a larger market share: between 1997 and 2000, arrivals grew by 52 percent in Cuba and 34 percent in the Dominican Republic, against only 5 percent in the ECCU area. Volume stagnated in 2000 and dropped by 5 percent in 2001, as a result of the combined effect of the slowing world economy and the sharp drop in the fourth quarter, following the September 11 attacks.[1/] Tourism net earnings for the ECCU area fell by 7.5 percent in 2001 and are projected to have dropped a further 0.6 percent in 2002.

Caribbean Region: Stopover Tourist Arrivals					
(In 000's, unless otherwise indicated)					
	1997	1998	1999	2000	Prel. 2001
Caribbean total	17,778.8	18,446.5	19,049.3	20,301.8	19,479.8
ECCU area	853.8	865.1	900.0	898.5	852.6
Other Caribbean Countries [2/]	16,925.4	17,581.4	18,149.3	19,403.3	18,627.2
o/w: Cuba	1,170.1	1,415.8	1,602.8	1,774.0	1,774.5
Dominican Republic	2,211.4	2,309.1	2,649.4	2,972.6	2,777.8
ECCU share of Caribbean total (in percent)	4.8	4.7	4.7	4.4	4.4
ECCU share of world total (in percent)	0.14	0.14	0.14	0.13	0.12
Sources: Caribbean Tourism Organization; World Tourism Organization.					

Against the region's obvious natural advantages in tourism are several principal disadvantages: competition from emerging low-cost competitors in the Caribbean (Cuba and the Dominican Republic), lack of economies of scale owing to their small size, and periodic natural disasters (hurricanes). The latter are beyond control, although hurricane damage can be partly mitigated through insurance, but at high premiums. Competitiveness in tourism reflects both price and non-price factors, including the quantity and quality of hotels, restaurants and tourism facilities, service, air access and port facilities, other infrastructure, as well as marketing and promotion. ECCU countries are generally perceived to be high cost destinations. Some countries have in fact focused efforts toward creating niche markets and positioned themselves as high-end destinations.

1/ The long-term effect of the attacks is uncertain; in Antigua and Barbuda, the impact was much smaller than that following the 1995 hurricanes (see SM/02/69). The volume of cruise ship passengers continued to increase through 2001, and its growth continues to far outstrip stay-over visitors.

2/ Includes British Virgin Islands, Bahamas, Barbados, Belize, Bermuda, Cayman Islands, Guyana, Jamaica, Trinidad and Tobago Turks and Caicos Islands, Aruba, Bonaire, Curacao, Saba, St. Eustatius, St. Maarten, Guadeloupe, Martinique, Puerto Rico, US Virgin Islands, Cancun, Cozumel, Cuba, Dominican Republic, Haiti and Suriname.

23. **In the offshore banking and non-bank financial sectors, the mission welcomed the work underway to improve the regulatory and prudential framework**. Uniform regulatory bodies are to be established, with CARTAC assistance, in each member country as noted above, to supervise other domestic financial institutions except credit unions, and also offshore banks. The Monetary Council has agreed that the ECCB will be responsible for the supervision of the offshore sector, jointly with the national supervisory units. The mission welcomed the progress made in most of the six members in strengthening the supervisory environment and the continuing efforts to strengthen the anti-money laundering and countering the financing of terrorism mechanisms.

24. **The mission noted that given the large decline in offshore business in some countries, efforts would be needed to amalgamate supervision to avoid supervisory costs becoming a drain on the treasury.** The mission stressed the urgency of implementing these proposals as soon as possible, ahead of the FSAP expected in the second half of 2003. The viability of the **stock exchange**, which at present still suffers from a lack of product (only two listings, though additional listings are being prepared) could be supported by increased volumes in the RGSM. Efforts to extend the scope of the market beyond ECCU members, including cross listings of securities on other exchanges in the Caribbean region, should help to expand its activities.

25. **The mission discussed with the ECCB the stance of monetary policy and agreed that the overriding objective for monetary policy is to sustain the currency arrangement.** Consistent with this objective and with the current liquidity conditions and reserve requirements, the mission estimated that private sector credit and broad money could both grow by about 3-5 percent in 2003 (Table 3). The mission reviewed the operation of the inter-bank market and emphasized its importance in ensuring that uniform liquidity conditions prevail in the region.

26. **The mission suggested early abolition of the floor (reduced from 4 to 3 percent in September 2002) applicable to the interest rate on savings deposits, which would increase the responsiveness of interest rates to liquidity conditions.** The ECCB maintained its position that the floor serves to ensure a minimum return to depositors and encourage savings. The mission also noted the uneven interest rates and large spreads prevailing across the region, which were attributed principally to bank specific difficulties such as high operating costs and the high level of non-performing loans.

D. Regional Integration and Trade Policies

27. **The mission's discussions with the OECS focused on priorities and proposals for greater regional integration especially in the context of globalization and the Free Trade Area of the Americas (FTAA).**[14] The Heads of Government of the OECS have recently indicated their goal of an economic union, to be achieved by 2007; an implementation schedule is under discussion. The mission urged that the goal of free movement of goods and services, labor and capital should be realized well in advance of trade liberalization deadlines (FTAA in 2005, compliance with outstanding WTO commitments) and the loss of trade preferences for bananas and sugar (2006),[15] by a gradual integration and the removal of existing barriers in the

[14] See *Selected Issues*, Chapter VIII, January 13, 2003, http://www.imf.org.

[15] The preferential tariff and quota regime for banana exports to the EU will be phased out and be replaced by WTO-compatible tariff regime by 2006. The regime for sugar exports will be phased out by 2009.

various areas. The mission noted recent progress towards free movement of labor, plans for integrating the money and capital markets, and that a development charter for the region was approved in October 2002.

28. **The mission urged the two remaining countries to lower their tariffs as called for under the final phase of CARICOM's external tariff agreement,[16] and that all countries accelerate compliance with their outstanding WTO commitments.** While tariff restrictions for trade outside the CARICOM area are on average moderate, non-tariff barriers remain widespread.[17] The simple average tariff inclusive of customs charges for the six countries in the region is 16.9 percent (or 11.9 percent excluding customs charges), the highest tariff ranges from 40 percent to 200 percent, with widespread import licensing requirements and quantitative restrictions. In its June 2001 review, the WTO expressed concern about trade policies and practices in the region, including on the level of tariff, the existing quantitative restrictions (expected to be dismantled by 2005), the absence of WTO-consistent legislation and institutions in key areas (e.g., anti-dumping, trade-related aspects of intellectual property rights) and delays in notifications to the WTO. Revenue considerations and inadequate human and technical capacity were seen as the principal factors in delaying compliance.

29. **On external trade negotiations, the authorities viewed the imminent trade liberalization as a threat to the stability of the region,** and saw a need for a longer period of adjustment, particularly with respect to the loss of trade preferences and the FTAA. The mission encouraged a more positive approach—centering on the opportunities to be gained from trade liberalization rather than protection of a few activities in which the region may no longer have comparative advantage. Revenue losses from tariff reductions could be compensated by the introduction of a VAT-type indirect tax.

E. Structural Issues

30. **Regional efforts in the area of public expenditure management should reinforce efforts by governments to strengthen the budget process**. The mission saw the ECCB's fiscal machinery framework—including work on convergence targets and transparency of fiscal operations and guidelines—as encouraging and urged early implementation with appropriate

---

[16] The final phase stipulates lowering the common external tariff (CET) to a maximum of 20 percent for non-agricultural products, while agricultural products attract a maximum tariff of 40 percent. Antigua and Barbuda and St. Kitts and Nevis have yet to reach the final phase, by lowering their non-agricultural tariffs from a maximum of 25 percent.

[17] The Fund's trade restrictiveness indices for ECCU countries are: Antigua and Barbuda, 7; Dominica, 6; Grenada, 6; St. Kitts and Nevis, 6; St. Lucia, 5; and St. Vincent and the Grenadines, 5. These indices indicate that the trade regimes are moderately restrictive.

monitoring. The mission suggested that a fiscal ROSC would be useful to help identify areas for improvement, as well as continued technical assistance from CARTAC and FAD. The mission discussed the ongoing regional public expenditure review by the World Bank, which should result in an action plan to increase the efficiency of government spending. The mission urged the CDB to accelerate a review and prioritization of public sector investment programs (PSIPs) with national authorities and result in national budgets containing realistic PSIPs that promote growth, competitiveness, and poverty reduction. More generally, the mission urged the authorities to accelerate public sector reform, including in the civil service and privatization.

31. **The mission shared the ECCB's and CDB's concern that more needs to be done to improve governance in the region,** particularly in the public sector. Public accountability was considered to be poor in many countries. Public accounts committees should ensure that audited statements of the government's finances were completed on time and published according to the law, and the Auditor General should discuss issues arising from these statements. The RGSM should require timely publication of transparent fiscal performance data.

32. **The discussion on labor issues focused on efforts to reduce unemployment, increase the flexibility of the labor market, enhance the skill-composition of the labor force, and keeping wage growth in line with productivity.** Unemployment rates are high in the region[18] and more workers are expected to enter the labor market as they are released from the public sector and other sectors that succumb to competitiveness pressures. The mission underscored the urgency for measures to increase the flexibility of the labor market, including an efficient mechanism to impart the needed skills, which would allow a resurgence of growth to generate needed employment. The mission welcomed ongoing efforts in the public and private sectors to institute training programs, and recommended their greater coordination within the region. The mission also raised the **urgent need for a regional approach to pension reform**[19]—both in terms of the structure of the national social security and government pension systems and their potential liabilities, and in light of the anticipated free movement of labor, similarities in the national schemes and the integration of the financial markets.

33. **Risk management and a more proactive approach to insure against natural disasters are needed.** Given the frequency of weather-related disasters, the region with help from the World Bank in an already negotiated project, should benefit from a coordinated approach to insurance for disaster mitigation.

---

[18] Unemployment data in the region are especially weak. Recent estimates of the unemployment rate range from 8 percent in Antigua and Barbuda, 12 percent in Grenada, 16 percent in Dominica, 18 percent in St. Lucia, and 20 percent in St. Vincent and the Grenadines.

[19] See *Selected Issues*, Chapter VII, January 13, 2003, http://www.imf.org.

F. Statistical and Other Issues

34. **The mission discussed plans to strengthen statistical practices in the region.** Deficiencies are noted in the labor, debt, and national accounts data, along with weaknesses with regard to the coverage, quality, and timeliness of trade, balance of payments, fiscal and price data. The ECCU countries participate in the GDDS, and their metadata highlight the various deficiencies in their macroeconomic data that impede timely and accurate policy analysis, as well as plans for improvements that would address these problems. The mission encouraged the ECCB to play a greater role in assisting member countries to meet their obligations to review their GDDS metadata at least once a year. Such updates would help document and evaluate the results of continuing efforts of members to improve their statistical systems. With the exception of Antigua and Barbuda, the other ECCU members need to document developments since the initial posting of the metadata. The mission also encouraged the ECCB to make greater efforts to address data quality issues, especially of coverage and timeliness, in areas within its own responsibility. CARTAC will continue to play a role in providing technical assistance in national accounts, CPI, and balance of payments statistics.

35. The ECCB indicated that priorities for **technical assistance** include advice on **pension reforms** and **public expenditure management**. A conference by Fiscal Affairs Department and CARTAC on the latter is being planned for early 2003.

IV. Staff Appraisal

36. **The unprecedented decline in output in the ECCU region in 2001 appears to have been followed by another year of negative growth in 2002.** The effects of September 11 still linger with tourism continuing to be adversely affected by the slowdown in travel. A few countries have been adversely affected by tropical storm Lili in September 2002, further dampening an early recovery in 2003. The prospects for 2003 depend on the extent of a recovery in the global economy, and domestic policy adjustment. Inflation is likely to remain subdued for the region as a whole, while unemployment remains a concern.

37. **The fiscal deficits in the ECCU are unsustainable, and pose a risk to the stability of the currency board arrangement. Early fiscal consolidation is needed in the region.** The first step should be to stabilize public debt ratios and reduce fiscal vulnerabilities; without significant adjustment, they will continue to rise. Efforts should focus on public expenditure management and spending controls (especially of the wage bill), and public sector investment programs should concentrate on projects geared to growth and poverty reduction funded largely by grants and concessional loans. An early reduction in tax exemptions and discretionary concessions is essential. A restructuring of the revenue base through a broadening of the tax base (with the possible introduction of a VAT-type tax) and a reduced reliance on trade tariffs will be key to putting the region on a strong footing in advance of the FTAA in 2005. Over the medium term, the aim should be to at least reach the proposed fiscal targets established by the ECCB; in individual countries, particularly those with current high debts and more vulnerable to

hurricanes, where more adjustment would likely be required. Fiscal transparency and governance needs to be improved, and a fiscal ROSC would be helpful in this regard.

38. **The ECCB is to be commended for spearheading a stabilization program including the use of fiscal benchmarks** to help establish a framework of macroeconomic policies over the medium term. This should be helped by the SATAP/CARTAC supported technical assistance being delivered in each country. It is important that the Monetary Council monitor and discuss, on a regular basis, the performance of all members in meeting the targets. Strengthened debt management will also play a crucial part in improving fiscal outcomes and lessening exposure to funding (rollover) risk.

39. **The health of the financial system in the ECCU is mixed and needs further strengthening.** Recent amendments to the Banking Act and the ECCB Agreement Act—the main legislative tools for governing the financial system—are due to be enacted by January 2003. Concerns still remain, including in regard to the requirement for contingency plans for insolvent banks and closures of problem institutions, and the region needs to establish quickly the uniform agencies in each jurisdiction to regulate non-bank financial institutions (credit unions, insurance companies etc.) and the offshore sector. Problem banks, mostly state-owned domestic institutions, need to reduce their non-performing loan portfolios, and in some cases be recapitalized.

40. **As for the offshore sector,** measures taken to improve and enhance supervision of the offshore financial centers have succeeded in reducing reputational damage in most of the ECCU. However, prospects are dim for the ECCU to sustain a vibrant offshore industry over the medium term. Offshore sectors should be kept under close review to ensure that the costs of supervision do not outweigh the overall economic benefits of the sector; some reduction of costs might be obtained by combining supervision of the offshore sector with that of domestic non-banks, as suggested by CARTAC. The authorities should continue their efforts to raise supervision to international standards and best practices to contain reputational risk. In particular, strengthening their anti-money laundering and countering the financing of terrorism mechanisms with Fund technical assistance where appropriate will be important. The region stands to benefit from the planned FSAP in the second half of 2003.

41. **Efforts are needed to stem erosion in external competitiveness in order to achieve sustainable growth.** Given the fixed exchange rate regime, which has served the region well in the past, the authorities are urged to focus on enhancing competitiveness and structural reforms. Holding economy wide wages constant in real—or preferably nominal—terms, increasing productivity and working with tripartite councils (between business, labor and government) should be pursued. The loss of market share in the global tourism market over the last five years is one indicator that improvements are warranted. Absent determined action to strengthen competitiveness, there is the risk of prolonged stagnation and rising poverty.

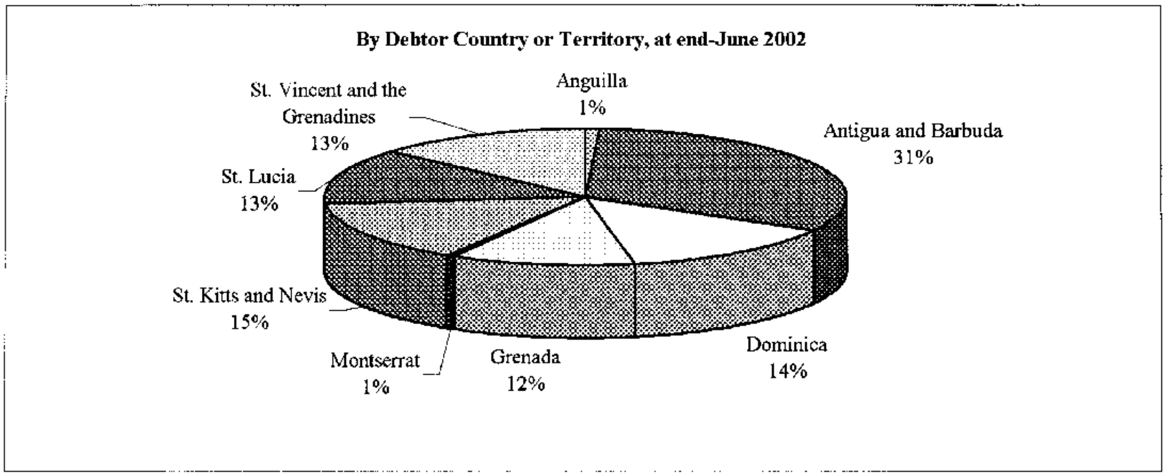
42. **The ECCU region could benefit from deeper structural reforms to improve efficiency, particularly as it advances towards greater regional and global integration.** In

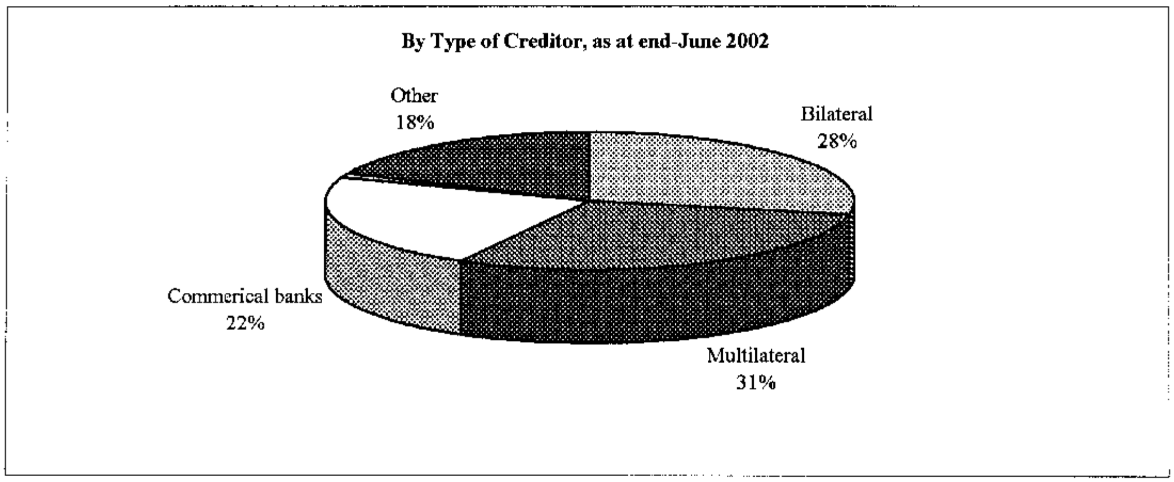
order to meet the OECS' goal of a single market and economy by 2007, the authorities are urged to speed up plans to position the region to take advantage of the FTAA negotiations. More aggressive efforts towards privatization, civil service and public sector reforms (including of the pension systems) will be needed. Labor market reforms, especially in training and improving flexibility, will also be important.

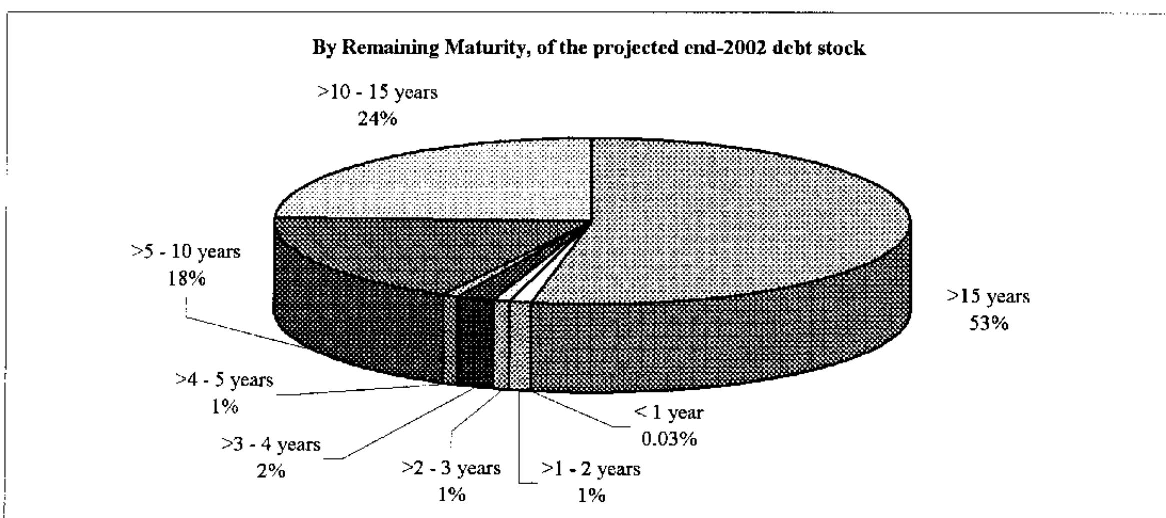
43. **The statistical data and practices in the region are weak and urgent improvements are needed in some key areas**, including in national accounts and the labor market. Efforts to improve the quality, transparency, and timeliness of economic data are also required.

44. It is proposed that the next discussions with ECCU regional institutions take place in 12 months.

Figure 3. ECCU—Composition of External Public Sector Debt



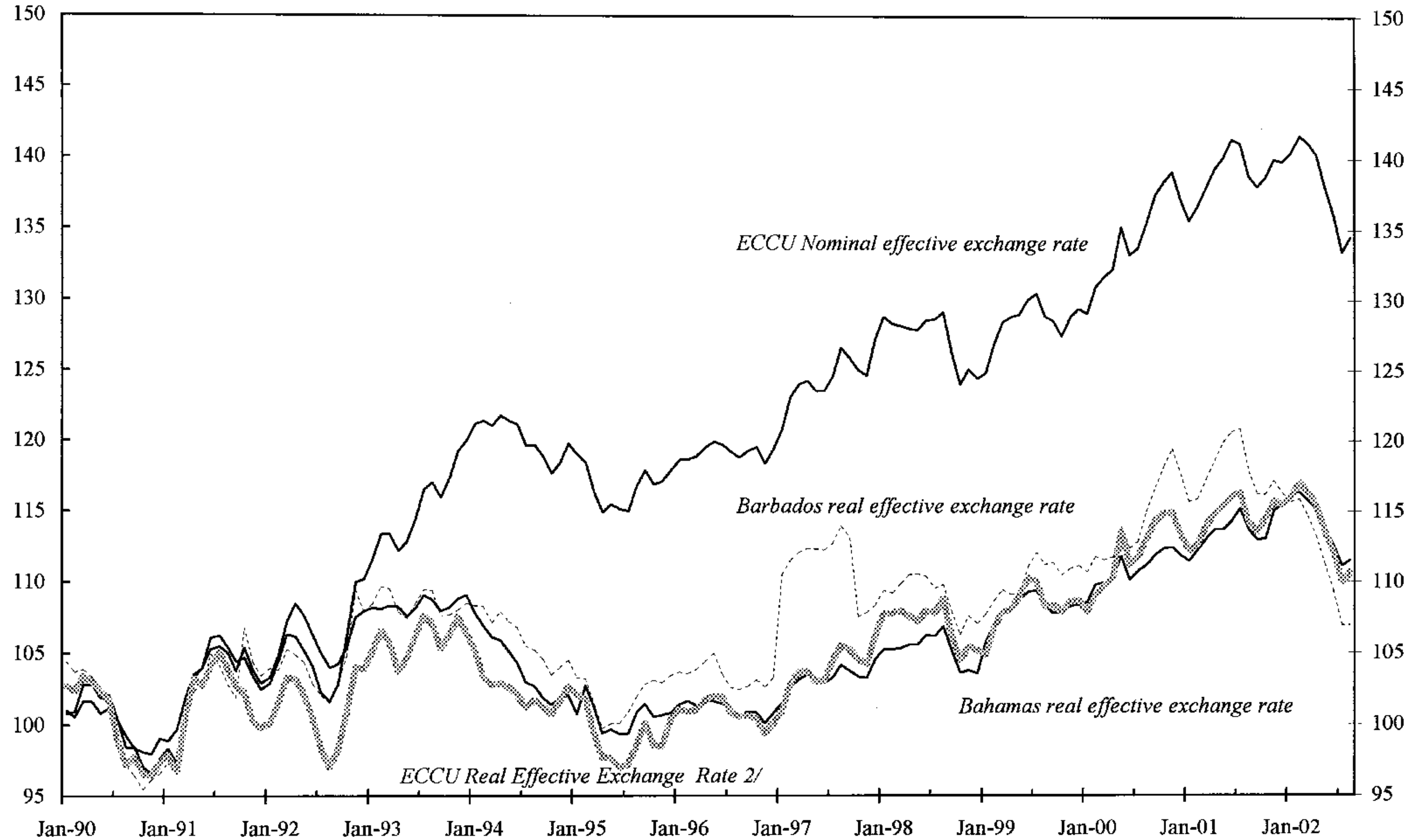




Source: Data provided by the Eastern Caribbean Central Bank.

Figure 4. ECCU: Effective Exchange Rate Developments, January 1990-August 2002 1/

(Index 1990=100)

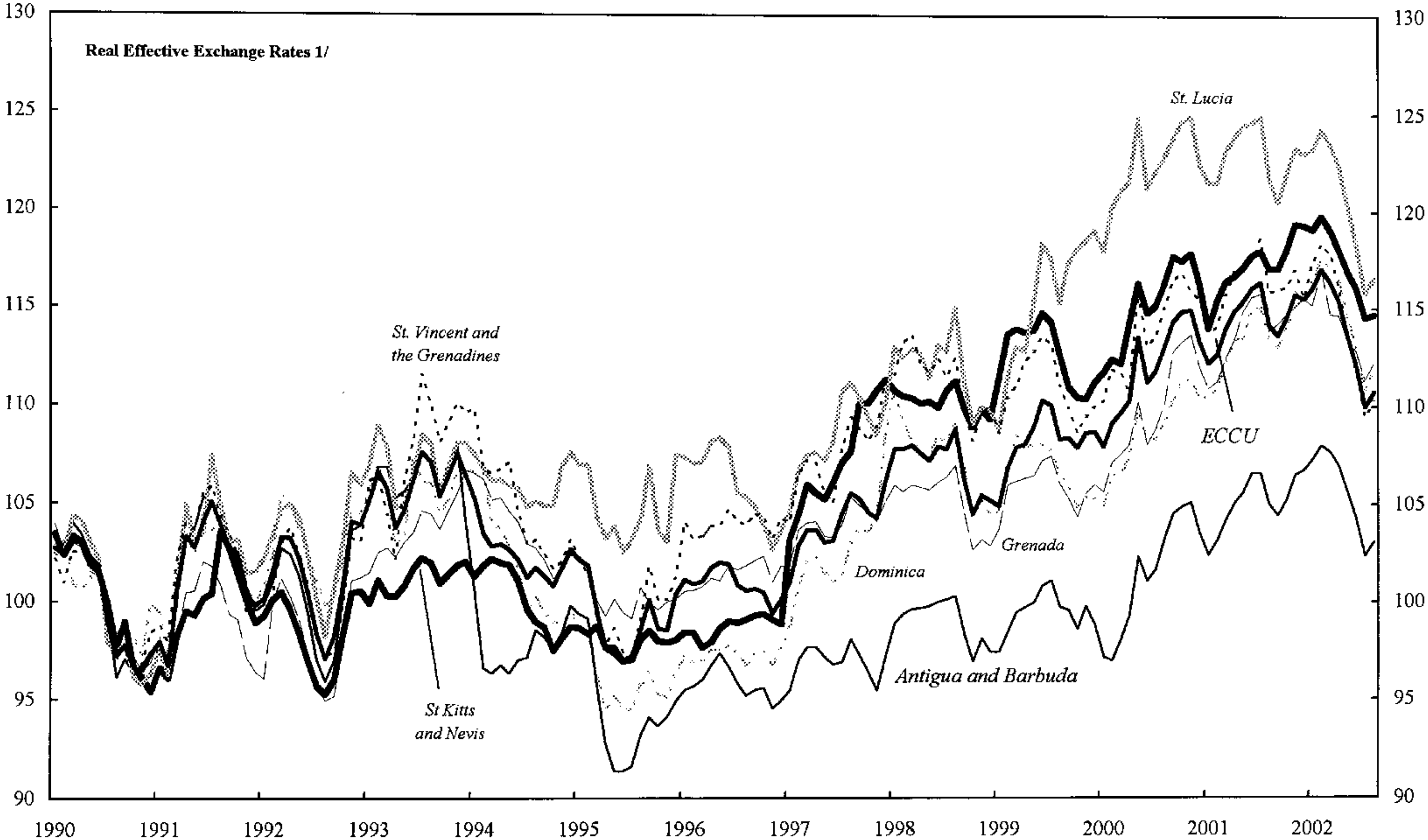


Source: IMF, Information Notice System and Staff calculations.

1/ Excludes Anguilla and Montserrat. An increase in the indices indicates an appreciation.

2/ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices.

Figure 5. ECCU: Real Effective Exchange Rate Developments in the Fund-Member Countries
(Index 1990=100)



Sources: IMF Information Notice System; and staff estimates.

1/ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices. An increase (decrease) indicates an appreciation (depreciation). Excludes Anguilla and Monteserrat in the calculation of the ECCU average.

Table 2. ECCU: Selected Economic and Financial Indicators

	1998	1999	2000	2001	Proj. 2002	Proj. 2003
(Annual percentage change; unless otherwise specified)						
National income and prices						
Real GDP	4.0	4.1	2.4	-1.5	-0.4	2.8
GDP deflator	2.8	1.4	1.6	1.8	2.0	2.0
Consumer prices						
End-of-year	0.9	2.1	3.1	2.0	1.5	1.5
Period average	3.7	3.4	2.1	1.5	1.7	1.5
External sector						
Exports, f.o.b.	5.9	3.5	7.6	-13.6	4.7	5.1
Imports, c.i.f.	4.2	6.5	2.7	-7.9	-1.2	6.7
Export volume	14.0	13.4	12.9	-12.2	1.4	0.8
Import volume	10.9	8.3	3.6	-4.8	-3.2	2.7
Terms of trade (deterioration -)	-1.2	-7.2	-3.8	1.7	1.1	0.2
Stayover visitors	1.5	-0.7	0.2	-5.1	-5.4	4.0
Nominal effective exchange rate;						
(1990=100) end-of-period (depreciation -) 1, 2/	-2.2	4.0	6.0	1.9	-3.1	...
Real effective exchange rate;						
(1990=100) end-of-period (depreciation -) 1, 2/	-1.0	3.4	3.8	0.8	-3.0	...
Banking system						
Net foreign assets 3/	8.0	-2.2	-1.5	6.9	1.3	1.2
Net domestic assets 3/	4.9	12.9	12.1	-1.0	2.0	4.0
Of which						
Credit to public sector	-1.4	2.5	2.8	0.6	-0.1	-0.1
Credit to private sector	8.2	10.1	10.2	2.3	2.5	4.5
Broad Money 3/	12.9	10.6	10.6	5.9	3.3	5.2
Of which						
Money	2.9	2.1	0.4	0.6	0.3	0.9
Quasi-money	9.9	8.5	10.2	5.3	3.0	4.3
Weighted deposit rates (in percent per annum)	4.3	4.3	4.5	4.3	4.3	4.3
Weighted lending rate (in percent per annum)	11.6	12.0	11.9	11.5	11.5	11.5
Nonperforming loans to total loans (percent)	...	14.9	11.7	13.6	...	...
(In percent of GDP)						
Public sector						
Overall central government balance	-1.6	-3.0	-4.3	-6.5	-6.4	-3.5
Total revenue and grants	29.1	28.4	27.8	27.5	29.3	29.5
Total expenditure and net lending	30.7	31.4	32.1	34.0	35.7	33.0
Foreign financing	1.7	2.1	1.9	3.3	...	...
Domestic financing including arrears	0.0	0.9	2.4	3.2	...	...
Central government current account balance	2.3	1.9	1.2	-1.0	-0.7	1.2
External sector						
External current account balance	-14.3	-16.1	-14.6	-14.4	-13.9	-15.3
Trade balance	-37.9	-38.5	-37.7	-35.3	-33.7	-34.5
Services and transfers	23.6	22.4	23.1	20.9	19.8	19.2
Of which						
Travel	31.1	29.6	28.9	26.8	26.0	26.0
Capital and financial acounts 4/	16.5	16.9	15.3	16.8	14.5	16.0
External public debt (end-of-period) 1/	39.8	41.9	45.3	49.9	54.3	54.0
Of which (in percentage of total)						
Multilateral and bilateral creditors	74.1	69.6	66.1	...	...	...
Other creditors	25.9	30.4	33.9	...	...	...
(In millions of U.S. dollars; unless otherwise specified)						
Gross international reserves of the ECCB, end-of-period	357.6	364.6	383.7	446.0	461.0	481.0
In months of imports	3.3	3.2	3.2	4.1	4.3	4.2
In percent of broad money	19.8	18.2	17.4	19.1	19.1	18.9
Currency backing ratio, in percent 5/	97.7	93.4	94.2	97.1	97.1	97.1

Sources: Data provided by the Eastern Caribbean Central Bank; and Fund staff estimates and projections.

1/ Excludes Anguilla and Montserrat.

2/ Figure shown in the 2002 column is the 12-month change to end-August.

3/ In relation to liabilities to private sector at the beginning of the period.

4/ Includes errors and omissions.

5/ ECCB's net foreign assets less banker's fixed deposits as a ratio of its demand liabilities.

Table 3. ECCU: Summary Accounts of the Banking System
(In millions of Eastern Caribbean dollars)

	1998	1999	2000	2001	Proj. 2002	Proj. 2003
I. Consolidated Banking System						
Net foreign assets	**999.0**	**889.5**	**806.7**	**1,218.6**	**1,297.9**	**1,375.8**
Net domestic assets	**3,880.2**	**4,507.3**	**5,162.0**	**5,101.0**	**5,227.2**	**5,491.2**
Net credit to the public sector	-111.3	8.4	161.3	198.9	190.8	184.3
Central government	459.5	517.8	685.3	697.5	698.3	716.2
Nonfinancial public enterprises 1/	-570.9	-509.4	-524.0	-498.6	-507.4	-531.9
Credit to the private sector	4,799.9	5,293.4	5,842.8	5,978.8	6,137.2	6,433.3
Other	-808.4	-794.5	-842.2	-1,076.7	-1,100.8	-1,126.5
Liabilities to private sector (M2)	**4,879.1**	**5,396.8**	**5,968.6**	**6,319.6**	**6,525.1**	**6,866.9**
Money	1,088.5	1,191.0	1,211.7	1,246.0	1,263.4	1,323.6
Quasi-money	3,790.6	4,205.8	4,757.0	5,073.6	5,261.7	5,543.3
II. Eastern Caribbean Central Bank						
Net foreign assets	961.4	975.9	1018.8	1192.2	1221.0	1275.0
Net domestic assets	-616.9	-586.9	-631.9	-818.7	-856.1	-892.7
Net position with banks and other instns.	-613.1	-632.6	-655.2	-845.3	-845.8	-876.9
Credit to government	58.0	65.9	69.6	75.8	54.7	50.2
Other	-61.7	-20.3	-46.3	-49.2	-65.0	-66.0
Liabilities to private sector	**344.5**	**388.9**	**386.9**	**373.4**	**376.6**	**394.0**
Currency issued	475.7	572.7	536.0	537.5	546.3	572.6
Currency held by banks	-131.2	-183.8	-149.1	-164.1	-169.7	-178.7
III. Commercial Banks						
Net foreign assets	37.6	-86.4	-212.1	26.5	65.2	89.1
Net claims on ECCB	595.0	628.7	632.2	833.2	833.7	864.8
Net domestic credit	**3,902.1**	**4,465.5**	**5,161.6**	**5,086.6**	**5,249.6**	**5,519.1**
Net credit to the public sector	-169.3	-57.5	91.6	123.2	136.1	134.2
Central government	401.6	451.9	615.7	621.8	643.5	666.1
Rest of the public sector	-570.9	-509.4	-524.0	-498.6	-507.4	-531.9
Credit to the private sector	4,799.9	5,293.4	5,842.8	5,978.8	6,137.2	6,433.3
Other	-728.5	-770.4	-772.9	-1,015.4	-1,023.7	-1,048.4
Liabilities to the private sector	4,534.7	5,007.9	5,581.7	5,946.2	6,148.5	6,472.9
Memorandum items of the consolidated banking system:						
(12-month change in percent of M2 at the beginning of the period)						
Liabilities to private sector (M2)	12.9	10.6	10.6	5.9	3.3	5.2
Net foreign assets	8.0	-2.2	-1.5	6.9	1.3	1.2
Central bank	3.4	0.3	0.8	2.9	0.6	0.8
Commercial banks	4.6	-2.5	-2.3	4.0	0.6	0.4
Net domestic assets	4.9	12.9	12.1	-1.0	2.0	4.0
of which: Net credit to the public sector	-1.4	2.5	2.8	0.6	-0.1	-0.1
Credit to the private sector	8.2	10.1	10.2	2.3	2.5	4.5
(Annual percentage change)						
Net foreign assets	52.9	-11.0	-9.3	51.1	6.5	6.0
Central bank	17.8	1.5	4.4	17.0	3.4	4.4
Commercial banks	-123.2	-329.8	145.5	-112.5	146.4	36.6
Net domestic assets	5.7	16.2	14.5	-1.2	2.5	5.0
of which: Net credit to the public sector	122.6	-107.6	1810.3	23.4	-4.1	-3.4
Credit to the private sector	8.0	10.3	10.4	2.3	2.6	4.8
Monetary liabilities (M2)	12.9	10.6	10.6	5.9	3.3	5.2
Money	13.2	9.4	1.7	2.8	1.4	4.8
Quasi money	12.8	11.0	13.1	6.7	3.7	5.4
Income velocity of broad money	1.44	1.37	1.28	1.22	1.20	1.19
Private sector credit/GDP (percent)	68.5	71.5	76.3	77.8	78.6	78.6
Broad money/GDP (percent)	69.6	72.9	78.0	82.3	83.6	83.9
Foreign currency deposits/GDP (percent)	6.8	7.5	10.0	10.4	10.6	10.7

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes the national insurance schemes.

Table 4. ECCU: Summary Balance of Payments
(In millions of U.S. dollars)

	1998	1999	2000	Prel. 2001	Est. 2002	Proj. 2003
Current account	**-370.7**	**-441.5**	**-414.0**	**-410.2**	**-402.8**	**-464.1**
Trade balance	-982.8	-1,056.4	-1,069.3	-1,005.1	-975.5	-1,046.5
Exports	315.8	326.8	351.8	303.9	318.2	334.3
Imports	-1,298.6	-1,383.2	-1,421.0	-1,309.1	-1,293.7	-1,380.8
Services and income	481.1	481.0	491.6	481.1	458.2	467.2
Services	627.9	656.4	692.5	657.3	634.1	655.7
of which: Travel	807.8	812.0	818.6	761.8	752.8	787.5
Income	-146.8	-175.4	-200.9	-176.2	-175.9	-188.5
Current transfers	131.0	133.9	163.6	113.8	114.4	115.1
Capital and financial account	**428.9**	**463.0**	**432.9**	**477.3**	**417.8**	**484.1**
Direct investment	312.9	333.0	303.4	275.6	242.6	300.1
Public sector long-term	40.1	42.1	37.2	70.7	93.8	70.0
Portfolio investment	6.3	46.5	48.6	35.0	61.3	40.0
Other 1/	69.6	41.4	43.7	96.0	20.1	74.0
Overall balance	**58.2**	**21.5**	**18.9**	**67.1**	**15.0**	**20.0**
	(in percentage of GDP)					
Current account	**-14.3**	**-16.1**	**-14.6**	**-14.4**	**-13.9**	**-15.3**
Exports	12.2	11.9	12.4	10.7	11.0	11.0
Imports	-50.0	-50.5	-50.1	-46.0	-44.7	-45.6
Services and income	23.6	22.4	23.1	20.9	19.8	19.2
of which: Travel	31.1	29.6	28.9	26.8	26.0	26.0
Current transfers	5.0	4.9	5.8	4.0	4.0	3.8
Capital and financial account	**16.5**	**16.9**	**15.3**	**16.8**	**14.5**	**16.0**
of which: Direct investment	12.1	12.1	10.7	9.7	8.4	9.9
Overall balance	**2.2**	**0.8**	**0.7**	**2.4**	**0.5**	**0.7**
	(Annual percentage change)					
Exports	5.9	3.5	7.6	-13.6	4.7	5.1
Imports	4.2	6.5	2.7	-7.9	-1.2	6.7
Travel, net	4.5	0.5	0.8	-6.9	-1.2	4.6
Memorandum Items:						
End year gross reserves of the ECCB, US$ millions	357.6	364.6	383.7	446.0	461.0	481.0
in months of current year imports (months)	3.3	3.2	3.2	4.1	4.3	4.2

Source: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes errors and omissions.

Table 5. ECCU: Selected Central Government Budget and Public Debt Indicators 1/
(As a percentage of GDP)

	1998	1999	2000	2001	Est. 2002	Proj. 2003
		Central Government Budget				
Total Revenue	**25.9**	**26.2**	**25.4**	**24.7**	**25.1**	**25.8**
Antigua and Barbuda	21.0	19.9	18.3	18.5	21.0	21.0
Dominica	29.2	29.5	29.5	28.3	25.3	28.9
Grenada	25.4	26.2	27.1	26.3	26.4	27.8
St. Kitts and Nevis	31.5	30.8	29.0	28.6	31.8	32.9
St. Lucia	25.8	27.3	26.1	24.1	21.9	21.9
St. Vincent and the Grenadines	28.7	29.2	28.9	29.0	30.4	30.6
External Grants	**2.2**	**1.9**	**1.1**	**2.5**	**1.8**	**1.8**
Antigua and Barbuda	0.9	0.3	0.0	1.1	1.0	1.0
Dominica	2.2	4.1	2.7	9.4	1.9	3.3
Grenada	4.6	1.9	3.0	4.2	3.5	2.5
St. Kitts and Nevis	0.1	0.9	0.8	0.5	2.2	1.5
St. Lucia	3.3	3.4	0.6	1.5	1.5	2.3
St. Vincent and the Grenadines	1.7	1.4	1.1	1.8	1.7	1.0
Current expenditures	**24.0**	**24.1**	**24.8**	**26.2**	**26.8**	**26.3**
Antigua and Barbuda	24.4	24.3	23.7	23.5	24.0	23.6
Dominica	27.6	27.8	30.2	32.0	31.8	32.1
Grenada	23.9	21.4	21.0	24.0	24.4	25.3
St. Kitts and Nevis	30.4	33.2	33.9	33.0	36.4	34.6
St. Lucia	19.4	19.3	20.8	23.4	23.1	22.3
St. Vincent and the Grenadines	23.8	25.2	26.4	28.3	28.9	27.6
Interest payments	**2.6**	**2.9**	**3.1**	**3.5**	**4.1**	**4.5**
Antigua and Barbuda	4.4	4.7	4.1	3.8	4.2	4.3
Dominica	2.6	2.5	3.9	5.0	5.2	5.8
Grenada	1.6	2.3	2.2	2.6	3.4	5.3
St. Kitts and Nevis	3.2	3.9	5.0	5.7	7.6	7.9
St. Lucia	1.3	1.3	1.6	2.3	2.8	2.7
St. Vincent and the Grenadines	1.9	2.6	2.6	3.0	2.8	3.0
Saving	**1.3**	**1.8**	**0.4**	**-1.7**	**-2.0**	**-0.7**
Antigua and Barbuda	-4.0	-4.6	-5.8	-5.1	-3.1	-2.8
Dominica	0.2	0.9	-1.0	-4.1	-6.7	-3.4
Grenada	1.3	4.8	6.1	2.3	1.8	2.2
St. Kitts and Nevis	0.2	-2.6	-5.2	-4.9	-5.4	-1.9
St. Lucia	6.1	7.8	5.3	0.5	-1.3	-0.5
St. Vincent and the Grenadines	4.1	3.4	2.4	0.7	1.4	2.9
Primary balance	**-0.2**	**-1.4**	**-2.7**	**-4.1**	**-3.0**	**-0.2**
Antigua and Barbuda	-0.6	-3.5	-4.1	-5.9	-1.1	-0.5
Dominica	-1.1	-5.0	-7.5	-6.0	-5.5	0.0
Grenada	-1.5	-1.3	-1.0	-6.0	-1.9	1.1
St. Kitts and Nevis	-2.7	-7.3	-9.5	-6.8	-10.8	-0.7
St. Lucia	3.0	3.5	0.2	-1.5	-1.9	-1.0
St. Vincent and the Grenadines	-1.4	0.9	2.3	0.6	-0.7	0.5
Overall balance	**-2.8**	**-4.3**	**-5.8**	**-7.6**	**-7.1**	**-4.7**
Antigua and Barbuda	-5.0	-8.2	-8.1	-9.7	-5.3	-4.9
Dominica	-3.7	-7.4	-11.4	-11.0	-10.6	-5.8
Grenada	-3.1	-3.5	-3.2	-8.6	-5.3	-4.2
St. Kitts and Nevis	-5.9	-11.2	-14.4	-12.4	-18.4	-8.6
St. Lucia	1.8	2.3	-1.4	-3.8	-4.7	-3.6
St. Vincent and the Grenadines	-3.3	-1.7	-0.3	-2.4	-3.6	-2.5
		Government and Government Guaranteed Debt Stock				
Total debt	**62.3**	**66.0**	**69.6**	**79.7**	**87.3**	**89.1**
Antigua and Barbuda	91.1	86.8	83.5	84.5	84.8	83.6
Dominica	60.8	74.8	80.5	92.1	101.2	103.4
Grenada	41.9	37.9	51.0	85.0	103.8	105.5
St. Kitts and Nevis	95.3	108.5	115.4	138.0	160.9	168.6
St. Lucia	37.4	38.2	41.3	42.7	45.4	45.3
St. Vincent and the Grenadines	48.9	67.4	69.3	68.1	71.4	74.9
External Debt 2/	**39.8**	**41.9**	**45.3**	**49.9**	**54.3**	**54.0**
Domestic Debt	**22.6**	**24.1**	**24.4**	**29.8**	**33.0**	**35.1**

Sources: ECCU member country authorities; and Fund staff estimates.

1/ Excludes Anguilla and Montserrat.
2/ Includes external arrears.

Table 6. ECCU: Summary Medium-Term Projections

	2000	2001	Est. 2002	Proj. 2003	Proj. 2004	Proj. 2005	Proj. 2006	Proj. 2007
	(Annual percentage change)							
National income and prices								
Real GDP	2.4	-1.5	-0.4	2.8	3.4	3.3	3.3	3.3
GDP deflator	1.6	1.8	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP	4.1	0.3	1.6	4.8	5.5	5.6	5.6	5.6
Consumer prices (end-period)	3.1	2.0	1.5	1.5	1.5	1.5	1.5	1.5
External sector								
Exports, f.o.b.	7.6	-13.6	4.7	5.1	4.2	4.2	3.0	3.0
Export volume	12.9	-12.3	0.9	0.7	1.2	1.2	1.4	1.7
Imports, c.i.f.	2.7	-7.9	-1.2	6.7	3.8	4.0	3.3	3.5
Import volume	3.6	-4.9	-3.9	2.5	2.4	2.4	2.4	2.4
Terms of trade (deterioration -)	-3.8	1.7	0.9	0.2	1.6	1.4	0.7	0.3
Stayover visitors	0.2	-5.1	-5.4	4.0	3.0	2.5	2.5	2.5
	(in percent of GDP; unless otherwise specified)							
Central government								
Overall balance	-4.3	-6.5	-6.4	-3.5	-2.4	-1.6	-0.8	0.0
Total revenue and grants	27.8	27.5	29.3	29.5	29.8	30.2	30.6	31.0
Total expenditure and net lending	32.1	34.0	35.7	33.0	32.2	31.8	31.4	31.0
Current account balance	1.2	-1.0	-0.7	1.2	2.6	3.4	4.2	5.0
External sector								
Current account balance	-14.6	-14.4	-13.9	-15.3	-15.2	-15.5	-15.5	-15.6
Trade balance	-37.7	-35.3	-33.7	-34.5	-33.9	-33.4	-32.7	-32.1
Services, incomes and transfers	23.1	20.9	19.8	19.2	18.7	17.9	17.2	16.5
Of which								
Travel	28.9	26.8	26.0	26.0	25.5	24.8	24.1	23.4
Capital and financial accounts 1/	15.3	16.8	14.5	16.0	15.9	15.8	15.8	15.9
Overall balance	0.7	2.4	0.5	0.7	0.6	0.3	0.3	0.3
Gross international reserves of the ECCB, end-of-period:								
in millions of U.S. dollars	383.7	446.0	461.0	481.0	501.0	528.3	557.2	587.6
in months of imports	3.2	4.1	4.3	4.2	4.2	4.3	4.3	4.4

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes errors and omissions.

Table 7. ECCU: Indicators of External and Financial Vulnerability

(12-month percentage change, unless otherwise stated)

	1998	1999	2000	Prel. 2001	Est. 2002	Proj. 2003
External indicators						
Merchandise exports	5.9	3.5	7.6	-13.6	4.7	5.1
Merchandise imports	4.2	6.5	2.7	-7.9	-1.2	6.7
Terms of trade deterioration (-)	-1.2	-7.2	-3.8	1.7	1.1	0.2
Tourism net earnings	4.5	0.5	0.8	-6.9	-1.2	4.6
Current account balance (percent of GDP)	-14.3	-16.1	-14.6	-14.4	-13.9	-15.3
Capital and financial account balance (percent of GDP) 1/	16.5	16.9	15.3	16.8	14.5	16.0
Of which:						
Foreign direct investment	12.1	12.1	10.7	9.7	8.4	9.9
Gross international reserves of the ECCB:						
In millions of U.S. dollars	357.6	364.6	383.7	446.0	461.0	481.0
In percent of broad money	19.8	18.2	17.4	19.1	19.1	18.9
Commercial banks' net foreign assets (millions of U. S. dollars)	13.9	-32.0	-78.6	9.8	24.1	33.0
External public debt (percent of GDP) 2/	39.8	41.9	45.3	49.9	54.3	54.0
Nominal exchange rate (end period, E.C. dollars per U.S. dollar)	2.7	2.7	2.7	2.7	...	...
Real effective exchange rate (end period, depreciation -)	-1.0	3.4	3.8	0.8	...	...
Financial indicators						
Broad money	12.9	10.6	10.6	5.9	3.3	5.2
Credit to the private sector	8.0	10.3	10.4	2.3	2.6	4.8
Share of nonperforming loans in total loans of banks (percent)	...	14.9	11.7	13.6	...	...
Ratio of banks' deposit liabilities to capital base (percent)	13.2	12.4	12.6	11.3	...	...
Ratio of banks' net liquid assets to total assets (percent)	19.7	20.6	19.5	24.5	...	...
Ratio of banks' before-tax profits to average assets (percent)	2.0	2.4	2.2	2.1	...	...
Weighted lending rate (in percent per annum)	11.6	12.0	11.9	11.5	11.5	11.5

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Excludes Anguilla and Montserrat.

OECS: Relations with the World Bank Group

(As of December 20, 2002)

The OECS has articulated a long-term sub-regional development strategy, contained in the OECS Development Charter and recent communiqués regarding the formation of an Economic Union. The IMF will continue to take the lead in helping the OECS to design regional and national macroeconomic programs aimed at maintaining fiscal sustainability and supporting growth. The IMF will lead the dialogue in macroeconomic policy, including the establishment of fiscal benchmarks, tax and banking reform. The Bank's program will focus on structural reforms aimed at raising international competitiveness and helping to managing volatility at the macroeconomic and household levels. The Bank will also take the lead on public sector reforms with a particular focus on efficiency of public spending, social expenditures (including safety nets) and disaster and environmental management. The Bank and Fund will work jointly on issues concerning the financial sector, both domestic and offshore. The Bank and the Fund will continue to collaborate with other donors in supporting the OECS, including through the Caribbean Technical Assistance Center in Barbados.

WORLD BANK GROUP STRATEGY

The World Bank's management presented to its Board an Eastern Caribbean Sub-Region Country Assistance Strategy (CAS), on June 28, 2001. The CAS which covers FY 2002–06, proposes new commitments of around US$110 million for the five borrowing member states of the OECS – Dominica, Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines. The main goals of the strategy are to build human and institutional capacity to meet the challenging economic and social environment facing these small states while reducing income insecurity and vulnerability at the national and household levels. Most new projects are being provided under a sub-regional umbrella mechanism, and in close collaboration with sub-regional organizations and external partners.

Increasing international competitiveness. Historically high growth rates in the OECS have slowed significantly in part due to declining aid and trade preferences, eroding price competitiveness, natural disasters and other exogenous shocks. The countries recognize that a continuous focus on improving competitiveness, in particular through productivity gains given the fixed exchange rate regime, is crucial to attracting private investment and accelerating diversification. In addition to stable macroeconomic conditions, they are focusing on (i) improving the investment climate by broadening the tax base, streamlining the investment incentive regime and making it more transparent; (ii) improving public sector performance, through reforms to raise the efficiency of public investments and improve service delivery; (iii) reducing high transaction costs, in part by strengthening regulation and efficiency of public utilities, and sea/air transport; and (iv) promoting appropriate education and skills development to ready their populations, including the poor, to take advantage of new opportunities in the global environment. The OECS authorities also recognize the need to expand their positive experiences with sub-regional functional cooperation (e.g., common central bank, telecommunications regulation, pharmaceutical procurement) to other areas as a way of better allocating the region's scarce human and financial resources.

The Bank is supporting these efforts through ongoing analytical work on **Institutional and Organizational Capacity** and a review of **Fiscal Issues** which will be followed by Bank support for a **Public Sector Reform program** in FY04; the **OECS Telecom Reform** project and a pilot **St. Lucia Water Sector Reform Project** are serving as a models for future work on **Regulatory Reform** for other utilities, and a new **Education Development** program to improve secondary education outcomes. A study on **Growth and Competitiveness** for the OECS will be prepared by the Bank in FY04.

Managing volatility. The extremely small and open OECS economies are vulnerable to both external shocks and natural disasters. On average, at least one major hurricane and numerous tropical storms cross the Caribbean each year, which can often cause losses exceeding annual GDP. Recent analytical work on macroeconomic vulnerabilities has shown that the frequent natural disasters in the OECS are a major cause of income insecurity and high poverty rates in the sub-region, as households cycle in and out of poverty in tandem with these events.

Disaster Management. Despite the regularity of natural disasters, the authorities in the OECS have generally pursued reactive policy responses and paid little attention to the critical mitigation measures, which has in turn kept fiscal, economic and social reconstruction and recovery costs high. Given declining aid flows and limited institutional capacity, the countries need to move to proactive responses with greater cooperation between governments, donors and civil society at both the national and the sub-regional levels. The Bank is working to strengthen mitigation and response planning through the **OECS Disaster Management** program and a recently negotiated **Catastrophe Insurance and Risk Management** project.

Safety Nets. Despite relatively high per capita incomes, unemployment (estimated between 5-20 percent) and poverty levels (ranging 12-38 percent) are quite high in the OECS. However, current safety nets suffer from a plethora of uncoordinated programs which lack appropriate targeting mechanisms and adequate coverage. These will need to be improved to address the impact of eroding trade preferences on the rural sector, emerging problems with youth-at-risk, an aging population, continued vulnerability to external shocks and new vulnerabilities arising from the HIV/AIDS epidemic. Given the difficult fiscal outlook over the medium term, the authorities will also have to broach the difficult question of rationalization and cost recovery in social services, which are being examined under the review of fiscal issues. Given the high levels of indebtedness, the Bank has steered away from significant lending for social protection and has provided financial support for a pilot **Poverty Reduction Fund** in St. Lucia, an ongoing **Social Safety Net Assessment (FY03) for Dominica** and an **IDF grant** to strengthen poverty measurement in the OECS. A **Caribbean Regional HIV/AIDS program,** including Barbados, was approved in June 2001 which will include projects for Grenada and St. Kitts (already prepared), **St. Lucia** (in FY03) and **St. Vincent** and **Dominica** (in FY04). A **review of Health Financing** is programmed for FY05.

BANK-FUND COLLABORATION IN SPECIFIC AREAS

Fiscal management. After a long period of reasonably sound fiscal management during the 1990s, most of the OECS have experienced significant deteriorations in their fiscal performance over the last few years. Given relatively low fiscal savings, governments have increasingly resorted to domestic and external commercial borrowing to finance public investment programs and to respond to natural disasters, and to extensive, and often ad hoc, tax concessions to promote private investment. This increased borrowing has added to debt service, strained limited fiscal resources, and, in some cases, is crowding out the private sector and putting pressure on the domestic financial sector. The OECS authorities recognize the need to strengthen revenue mobilization, address the level, composition and productivity of public expenditures and strengthen debt management if the countries are to regain the fiscal stability of previous years. To this end, they have proposed the establishment of fiscal benchmarks for the currency union. The Fund will spearhead support for developing these benchmarks and has taken the lead on tax reform efforts. The Bank is complementing this with work to help improve the management of public expenditures in the OECS, including reviews of: public expenditure policy and allocation (**Analysis of Fiscal Issues**); budget management with the Fund's FAD; financial management practices (**OECS Financial Accountability Assessment**); and procurement processes (**OECS Procurement Assessment Report**). These will be a critical focus of the upcoming **Public Sector Reform** operations scheduled for FY04.

Financial sector reforms. The OECS financial sector is currently facing pressure on the domestic side from growing fiscal deficits, and on the offshore side from increased international attention to the issue of money laundering. CARTAC is supporting work on strengthening the regulatory framework for the domestic banking sector, including strengthening the powers of the central bank to address the weak domestic banks. Four of the OECS countries were listed as non-cooperative territories on money laundering by the FATF in 2000 and by the FSF on prudential supervision of the offshore financial sector. Since then, the countries have completed Fund-assisted self-assessments of offshore regulatory and supervisory regime, and made progress in upgrading regulations and supervisory institutions. St. Kitts and Dominica were recently removed from the FATF list. As a result, many offshore banks have been de-licensed and there has been a general retrenchment in the sector. The Bank will continue to work together with the IMF and the ECCB to review fully the financial sector, including a planned Financial Sector Assessment in 2003 which will cover both on and onshore financial sectors. The Bank plans to support implementation of the FSAP recommendations with a **Financial Sector** operation in FY05.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/40
FOR IMMEDIATE RELEASE
March 28, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Discussion on the Eastern Caribbean Currency Union

On January 27, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the discussion of regional surveillance on the Eastern Caribbean Currency Union.[1]

Background

After growing at an average annual rate of 3½ percent in the 1990s, real GDP in the region grew by 2½ percent in 2000 but fell by 1½ percent in 2001, an unprecedented decline since 1976. This fall reflected a confluence of events: The September 11 terrorist attacks in the United States and their impact on tourism, steep declines in traditional products (notably bananas and sugar), natural disasters, and the global economic slowdown. Inflation remained subdued, with consumer prices rising on average by less than 3 percent per year. Unemployment appears to be high, although the data are very weak. There is also evidence of a loss of competitiveness in tourism and external trade. Economic activity in 2002 remained depressed as the impact of these factors have persisted, in addition to that of tropical storm Lili in September 2002.

The fiscal position of the governments in the region has deteriorated sharply in recent years, resulting in public sector dissavings, marked increases in public debt, and arrears in some cases. Higher spending was mostly on wage bills, capital projects, and interest payments, while widespread tax concessions lowered revenues. The combined central government deficit widened from 5½ percent of GDP in 2000 to around 7 percent of GDP in 2001, and is estimated

[1] The regional perspective of such discussions is intended to strengthen the bilateral discussions that the IMF holds with the members in the region under Article IV of the IMF's Articles of Agreement. A staff team staff team visits the region, collects economic and financial information, and discusses with officials of the regional institutions the region's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarized the views of Executive Directors, and this summary is transmitted to the country authorities in the region.

to have remained broadly unchanged in 2002. The combined stock of public sector debt grew to about 80 percent of GDP in 2001 and grew further in 2002; the debt stock of the countries in the region ranged between 40–135 percent of GDP at end-2001.

Gross international reserves of the ECCB have continued to rise and have remained at comfortable levels in recent years, despite the large current account deficits and declining external competitiveness. This reflects continued robust capital inflows, mainly direct investment to finance construction and imports for large projects but also public sector borrowing. However, with the slowdown in tourism and the weakening economy, travel receipts, imports and also exports fell sharply in 2001 and the current account deficit narrowed slightly to an estimated 15 percent of GDP.

Monetary aggregates grew strongly in 2000, with increased lending to governments and an increase in foreign currency deposits, but slowed in 2001 and 2002 as governments relied more on external borrowing, economic trends worsened and bank liquidity increased. The soundness of the domestic banking sector varies markedly among members, and the current weak economic conditions are causing the banking system to come under increased stress. In the offshore financial sector, efforts in the region have focused on strengthening the supervisory and regulatory framework, following the inclusion in 2000 and 2001 of four countries in the region in the Financial Action Task Force's (FATF) listing of noncooperative areas for inadequate anti-money laundering policies, and earlier listings by the Financial Stability Forum and the OECD. Since then two of these countries have been removed from the FATF's list.

Executive Board Assessment

Directors observed that the region has recently faced a series of adverse shocks, including natural disasters, the events of September 11, 2001 and the global economic slowdown. In particular, the weakness of the tourism sector has contributed to an unprecedented overall decline in GDP in both 2001 and 2002. Directors noted with concern that these developments have exacerbated the region's difficult economic challenges, and underscored the urgency of addressing these challenges with determination. Priority will need to be given to correct the deepening fiscal imbalances, in particular to safeguard the stability of the currency board arrangement and of the financial system, while structural reforms should aim at strengthening the region's competitiveness and growth potential.

Directors noted that efforts at fiscal consolidation and stabilizing public debt ratios will need to involve a range of actions. Expenditure measures should include wage restraint, improved public expenditure management (informed by World Bank public expenditure reviews), and greater focus on public sector investment projects that are geared to growth and poverty reduction and funded largely by grants and concessional loans. To strengthen the revenue effort, Directors urged an early reduction in tax exemptions and discretionary concessions, and a broadening of the tax-base, preferably on a regional basis and through the introduction of a VAT-type tax and reduced reliance on trade tariffs. Strengthened public debt management will also play a crucial part in improving fiscal outcomes and lessening vulnerabilities.

Directors welcomed the ongoing work coordinated by the Eastern Caribbean Central Bank (ECCB) in the tax, expenditure, and debt management areas. They commended the ECCB for its efforts to support fiscal reforms in the region, particularly in the context of stabilization programs, and saw the fiscal benchmarks being developed as a useful commitment mechanism to improve fiscal performance. Directors stressed that the fiscal authorities need to take full ownership of these regionally coordinated initiatives, and that their full and determined implementation will be key to ensuring fiscal sustainability. Regular monitoring of the performance of all members against the benchmarks will therefore be important to encourage peer review of poor performers within the Union, and to help ensure that all members achieve—at a minimum—the proposed benchmarks over the medium-term. Directors also underscored the need to improve fiscal transparency and governance in the region, and suggested that fiscal ROSCs for the members of the ECCU would be helpful in this regard.

Directors noted the mixed assessment of the health of the financial systems in the member countries, and called for measures to ensure bank soundness going forward. They welcomed plans to strengthen the domestic bank supervisory and regulatory regime in accordance with Basel Core Principles as well as the amendments to the Banking Act and the ECCB Agreement Act, and looked forward to their early enactment. Directors underscored the urgency of establishing uniform agencies in each jurisdiction to regulate non-bank financial institutions and the offshore sector. Problem banks need to reduce their non-performing loans and will, in some cases, have to be recapitalized.

Directors welcomed recent progress towards strengthening regulation and supervision in the offshore financial sector. However, prospects remain dim for sustaining a vibrant offshore industry over the medium term in the region. While efforts to raise supervision to international standards need to continue, it will also be important to work towards mechanisms that prevent the cost of supervision from outweighing the overall economic benefits of the sector. Directors encouraged the authorities to keep up the momentum in their efforts to strengthen the mechanisms to combat money laundering and the financing of terrorism. They supported the provision of Fund technical assistance for this purpose, and looked forward to the FSAP, to be conducted later this year.

Directors considered that the monetary and exchange rate system operated by the ECCB has generally served the region well in the past, and noted the ECCB's high currency backing ratio and comfortable level of international reserves. They cautioned, however, that preserving the exchange rate peg going forward will require sustained fiscal consolidation and a decline in public sector debt, a sound and well-regulated financial sector, and strengthened efforts to increase the region's competitiveness. Some Directors encouraged the authorities to keep the merits of the modalities of the currency peg under review. The authorities were also encouraged to abolish the floor on savings deposit rates to increase the responsiveness of interest rates to liquidity conditions.

Directors underscored the importance of determined efforts to strengthen external competitiveness and achieve sustainable growth. This will require strong wage restraint, and efforts to increase the flexibility of the labor market and enhance the skill-composition of the labor force. Directors also highlighted the benefits that the region would obtain from deeper structural reforms to improve efficiency, as it advances towards greater regional and global integration. They supported the goal to create an economic union by 2007, and encouraged the authorities to accelerate integration plans that would position the region to take full advantage of the anticipated Free Trade Area of the Americas and facilitate adjustment to the prospective loss of EU trading preferences for key agricultural products. Directors also recommended stronger efforts towards privatization, trade liberalization, civil service and public sector reforms–including pension reform—and improvements in the business environment. They noted that the region will need appropriate technical assistance to support its integration efforts.

Directors underscored the importance of strengthening economic statistics and addressing remaining weaknesses which hamper the quality of economic analysis. Improvement is most urgent in the national accounts and labor statistics, while further efforts are also required to improve the quality, transparency, and timeliness of economic data.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the Discussion on the Eastern Caribbean Currency Union is also available.

Eastern Caribbean Currency Union: Selected Economic Indicators

	1999	2000	2001	Est. 2002	Proj. 2003
Real Sector (Annual percentage change)					
Real GDP	4.1	2.4	-1.5	-0.4	2.8
GDP deflator	1.4	1.6	1.8	2.0	2.0
Consumer prices, end of year	2.1	3.1	2.0	1.5	1.5
Public Finances (in percent of GDP)					
Central government overall balance	-3.0	-4.3	-6.5	-6.4	-3.5
Revenues and grants	28.4	27.8	27.5	29.3	29.5
Expenditure and net lending	31.4	32.1	34.0	35.7	33.0
Total public sector debt 2/	66.0	69.6	79.7	87.3	89.1
External Sector (in percent of GDP, unless otherwise indicated)					
Current Account balance	-16.1	-14.6	-14.4	-13.9	-15.3
Trade balance	-38.5	-37.7	-35.3	-33.7	-34.5
Travel	29.6	28.9	26.8	26.0	26.0
Export volume 2/	13.4	12.9	-12.2	1.4	0.8
Import volume 2/	8.3	3.6	-4.8	-3.2	2.7
Stayover visitors 2/	-0.7	0.2	-5.1	-5.4	4.0
Money and Credit (percentage change)					
Net foreign assets 3/	-2.2	-1.5	6.9	1.3	1.2
Net domestic assets 3/	12.9	12.1	-1.0	2.0	4.0
Broad money	10.6	10.6	5.9	3.3	5.2

Sources: Data provided by the authorities, and IMF staff estimates.

1/ Excludes Anguilla and Montserrat.
2/ Annual percentage change.
3/ In relation to broad money at the beginning of the period.